

New Zealand

REVIEW OF THE KYOTO PROTOCOL PURSUANT TO ITS ARTICLE 9

September 2008

As invited by the Subsidiary Body for Implementation (SBI), as part of the preparations for the second review of the Kyoto Protocol¹, New Zealand welcomes the opportunity to provide views on two issues: 1) extending the share of proceeds to joint implementation and international emissions trading; and 2) enhancing equitable regional and sub-regional distribution of the CDM. These matters are linked to the work of the AWG-KP² on the analysis of means to reach emission reduction targets and identification of ways to enhance their effectiveness and contribution to sustainable development, and to the work of AWG-LCA³ on enabling the full, effective and sustained implementation of the Convention through long-term cooperative action now, up to and beyond 2012.

Summary

2 The proposal to **extend the share of proceeds to joint implementation and international emissions trading** should be seen in the context of a broader discussion on the funding of adaptation - an issue that cuts across both the Framework Convention and its Kyoto Protocol. New Zealand recognises that additional funding for adaptation is needed. In our view, the correct approach to adaptation funding is a cross-cutting one, first establishing the overall financial framework for adaptation before deciding which specific mechanisms will be used to raise funds. Predictability and sustainability of funding are important.

3 Extending the share of proceeds to joint implementation and international emissions trading raises important questions about the allocation of responsibility for adaptation funding. No changes should be made for the first commitment period. In the case of international emissions trading any levy that applied on transactions of units would present a risk to the efficiency of the carbon market. New Zealand looks forward to the secretariat technical paper for further clarification of the implications of these approaches.

4 New Zealand considers that **regional and sub-regional distribution of CDM** projects depends on the mechanism's design and implementation, and suggests several approaches to identifying and removing barriers, particularly in regions that have few or no projects. Such improvements could be considered for the first commitment period.

¹ FCCC/SBI/2008/8

² E.g. as presented as agenda item 3(a) for the discussions in Accra, Ghana (FCCC/KP/AWG/2008/4 refers)

³ E.g. as presented as agenda item 3 for the discussions in Accra, Ghana (FCCC/AWGLCA/2008/9 refers)

5 New Zealand does not support rule changes that seek to explicitly direct in which countries CDM projects should take place, as this would be at odds with the least-cost principle articulated in the Principles (Article 3.3) of the Framework Convention.

1) Extending the share of proceeds to assist in meeting the costs of adaptation to joint implementation and emissions trading

6 New Zealand agrees with the objective underlying this proposal: to provide increased funding for adaptation and identify means to deliver predictable and sustainable funding. At the same time, finance is a cross-cutting issue that needs to be discussed across the negotiating tracks of the Framework Convention and its Kyoto Protocol in a consistent and coherent manner if the current negotiations are to deliver effective decision making and efficient and effective outcomes.

7 Financing is a three-step process: assessing needs, collecting the funds, and delivering (according to need). Before deciding on how funds should be raised, Parties should first focus discussions on what needs to be accomplished through adaptation funding, rather than beginning with the mechanism for collecting funds. They should consider the need, identified in the Bali Action Plan, for financing to be adequate, predictable and sustainable, and for it not to have perverse outcomes for markets. It is important to analyse all options together in order to decide on which option or mix of options will be most effective and efficient in meeting adaptation needs.

8 New Zealand notes that the CDM adaptation levy was introduced to provide some benefits for CDM-eligible countries with an expected low CDM uptake. The proposal to raise funds for adaptation by applying a levy to joint implementation or international emissions trading, with funds to be disbursed to parties uninvolved in either activity, is of a different nature and context.

9 Extending the share of proceeds to **international emissions trading** by means of a levy at issuance, would mean that Parties were contributing to adaptation in direct proportion to their overall emissions allocation, and in inverse proportion to the ambition of their emissions reduction commitments. While this simple principle may have some merit, New Zealand believes that it needs further analysis against the criteria of environmental effectiveness, economic efficiency and equity of burden-sharing.

10 New Zealand also questions the idea of levying both AAUs and ERUs, as this would lead to a double levy on JI projects and could reduce investment in emission reduction activities in Annex 1 Parties.

11 New Zealand also notes that Parties use the flexible mechanisms to varying degrees, with some Parties trading internationally more than others. If the levy was a transaction levy rather than an issuance levy, extending the share of proceeds to international emissions trading would produce an unfair outcome as parties that traded more in units would carry a greater burden of adaptation funding than parties that chose to use regulatory or carbon charge

responses. This could have a perverse outcome on the choice of climate change responses, and could result in less mitigation taking place. Any levy that was applied on transactions of units would discourage trading activity and present a risk to the efficiency of the carbon market.

12 Consideration should also be given to the fact that the flexible mechanisms may not offer a predictable and sustainable source of funds due to supply/demand and price uncertainty beyond 2012.

13 New Zealand does not support imposing a levy or other intervention in the market during the first commitment period. Annex 1 Parties have implemented emissions trading schemes and other mechanisms, and businesses have made decisions in the expectation of a period of stability until the end of 2012. New Zealand considers that the introduction of a new intervention, independent of other reforms to the mechanisms, could create undesirable uncertainty in the international carbon market. This issue would be better addressed as part of the comprehensive post-2012 framework.

2) Ways and means to enhance the equitable regional and sub-regional distribution of CDM projects

14 There are a number of issues intertwined in the discussion of the need for more equitable regional and sub regional distribution of CDM projects. It is clear that in the first commitment period, CDM project activities will be concentrated in a relatively small number of countries and that there will be very limited uptake of CDM projects in Least Developed Countries (LDCs). This uneven distribution of projects is seen to be significant in the context of the CDM's role in promoting sustainable development and enhancing technology transfer. In the current CDM, there is a conflict between the principles of achieving the greatest emissions reductions at the least cost (which the current mechanism appears to do) and the effective transfer of low emissions technology (which it does less well, and indeed rewards mainly those countries which are comparatively well advanced in technologies).

15 Addressing this issue requires careful and pragmatic assessment of why the distribution of CDM is unfolding as it is, and more critically, consideration as to whether the CDM is the best mechanism to assist LDCs in achieving their sustainable development objectives or whether other instruments (existing or new, and not necessarily under the UNFCCC or its Kyoto Protocol) need to be developed to achieve these objectives more adequately.

16 It is important to recall that, as pointed out in paragraph 8 above, the CDM levy itself reflects a recognition by Parties that not all eligible countries will provide equally attractive business and investment opportunities for CDM activities.

17 Some of the key factors that are shaping the current distribution of CDM projects are the level of industrialisation of the economy, absolute levels

of energy consumption and greenhouse gas emissions and related to these, the magnitude of mitigation potentials. These economic factors will continue in the future to attract project developers seeking profitable investment opportunities that minimise transaction costs.

18 Notwithstanding these economic drivers, there are in New Zealand's view a number of positive steps that should be explored further with the aim of encouraging a more equitable regional distribution of projects. Such improvements could be considered in the first commitment period.

19 Firstly, and perhaps most significantly, proposals that have been put forward in the AWG KP to differentiate the eligibility of Parties to host CDM project activities, provide a real potential to refocus the CDM as an offsets mechanism towards LDCs and Small Island Developing States.

20 Secondly, rule changes to facilitate the uptake of small scale project activities should be considered. For example, increasing the maximum size of small scale project activities for certain host Parties or reducing additionality requirements for such projects being implemented in certain host Parties.

21 Thirdly, addressing the permanence issues under CDM rules on LULUCF could help encourage these types of projects in LDCs and generate important sustainable development co-benefits.

22 Fourthly, and more generally, although much has already been undertaken in programmes such as the Nairobi Framework by agencies such as the World Bank and the UNDP, there is undoubtedly much more than can still be done to identify and remove barriers to the implementation of CDM.

23 However, there are also in New Zealand's view, suggested rule changes that could be very detrimental to the cost effectiveness of the CDM as a market instrument. Negative developments would be rule changes that seek to explicitly direct in which countries CDM projects should take place. An example of such a rule change would be to require the purchase of minimum quota of CERs from particular host Parties. Such proposals would be practically difficult to administer and enforce (in particular on private sector entities participating in the market), and could significantly detract from the cost effectiveness of the CDM as a market mechanism. In this context such developments would be at odds with the least-cost principle articulated in the Principles (Article 3.3) of the Framework Convention, which state "*policies and measures to deal with climate change should be cost-effective so as to ensure global benefits at the lowest possible cost*".